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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)))))	MM Docket No. 92-266

Rate Regulation

To: The Commission

COMMENTS OF NATIONAL BROADCASTING COMPANY, INC. ON THIRD NOTICE OF PROPOSED RULEMAKING

National Broadcasting Company, Inc. ("NBC") submits the following comments in response to the Commission's Third Notice of Proposed Rulemaking[1] in this docket.

The Third Notice requests comment on, among other things, the appropriate methodology for adjusting rates capped under the benchmark approach when channels are added to or deleted from a system's lineup. As a holder of substantial interests in a number of cable programming services[2], NBC agrees with the Commission's tentative conclusion that the methodology adopted should provide sufficient incentives for cable operators to invest in continued growth of cable television service. Third

1 Third Notice of Proposed Rulemaking, MM Docket No. 92-266, FCC 93-428, released August 27, 1993.

2 NBC owns 100% CNBC and 100% of America's Talking, a new cable channel that will be launched in 1994. NBC also owns substantial interests in a number of other cable programming services including A&E, AMC, Prime Network, SportsChannel America, Bravo, Court TV, News 12 Long Island, and in nine regional sports cable services.

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Notice at 79, para. 136.

NBC believes that any formula that is consistent with the goal of growth of the cable industry, including growth in the number of high quality program services, must include two features. First, it must allow cable operators to recover all of their increased programming costs when new channels are added. Second, the formula must not erode cable operators' profit margins as programming costs increase.

NBC supports the Commission's tentative conclusion not to pursue the first or second approaches considered in the Third Notice. Under the first option, systems adding channels would continue to charge the "old" permitted per channel rate for "old" channels. New channels would be charged at the per channel benchmark rate for the new total number of channels. Since rates under this proposal would be set without regard to programming costs, operators would not necessarily recover all increased programming costs when new channels are added. The total permitted rate for all channels on a tier would be fixed, thus giving operators an incentive to fill new channels with the lowest cost programming available while assigning more expensive and higher quality programming to unregulated tiers.[3] Systems

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[3] The first proposal could be improved by allowing operators to recover any increased programming costs that exceed the programming component of the "new" benchmark rate for the "new" channels. This would eliminate the incentive to fill new channel capacity with the lowest cost programming.

should be encouraged to select programming that maximizes value and service to subscribers of the various tiers. They will not be encouraged to do so if they are asked to subsidize higher programming costs on the regulated tiers.

The second approach discussed in the Third Notice is unworkable for the same reasons. Under the second approach systems adding or deleting channels would simply adopt the benchmark rates for the new number of channels without regard to changes in programming costs. As the Commission notes, systems with permitted rates above the benchmark would have a substantial disincentive to add new channels, and systems below the benchmark would have an inappropriate incentive to change their channel lineup -- perhaps by dropping the most expensive channels altogether -- so that they might increase rates to the benchmark.

Both of these proposals should be rejected because they encourage operators to add or delete channels for reasons unrelated to the merit of the programming. The methodology adopted should not provide such unnatural incentives. The effect of the Commission's rate rules on programming changes should be as transparent as possible, so that operators may make channel line-up decisions without fear of losing money or suffering eroded profit margins as a result of those rules.

The third approach, with a minor modification, comes closest to meeting this ideal. Under the third approach systems would subtract actual programming costs from their permitted rates, then adjust the remainder of the permitted rate by the same fractional change in the benchmark, then add back in actual programming costs, adjusted for inflation. Because increases in programming costs would be passed through to the subscribers who benefit from the improved or expanded programming, artificial incentives to compromise program quality in order to remain profitable would be substantially reduced.

However, even under the third option, cable operators will have a real incentive to position higher cost programming on unregulated a la carte tiers, where they can earn a return on their higher costs. While this incentive probably cannot be engineered out of the rules entirely, its effects can be moderated somewhat by allowing cable operators to earn a proportionally increased profit on higher programming costs on regulated tiers. The Commission has correctly noted that if programming costs grow faster than inflation, but the benchmark (which includes the system's profit for regulated tiers) grows only with inflation, the operator's profit margin will erode over time. Third Notice at 78, n. 244. Decreased profit margins on regulated tiers would provide the same counterproductive incentives as would a refusal to allow systems to recover costs, although it may take more time for the effects to become apparent.

Allowing cable operators to recover increased programming costs and maintain profit margins as costs increase is consistent with 1992 Cable Act and with the Commission's conclusions in the first Report and Order in this docket.[4] The Act requires the Commission's rate regulations to be sensitive to the costs of programming and the need of cable systems to earn reasonable profits. Communications Act Section 623 (b)(2)(C). The Commission has also acknowledged the rights of cable operators to earn a "fair return" and a "reasonable profit." See, e.g., Report and Order, MM Docket 92-266, FCC 93-177, released May 3, 1993, pp. 9-11. Moreover, neither Congress nor the Commission intended that rate regulation should place unnecessary constraints on the programming market or otherwise have the effect of regulating programming. Id. at 10. Unless cable operators are allowed to recover increased program costs and to maintain reasonable profit margins as programming costs increase, the programming market will be constrained -- since operators' selection of programming for the regulated tiers will be driven by financial concerns rather than programming merit.

[4] FCC 92-266, released May 3, 1993.

The third option, modified to guard against erosion of profits, is consistent with statutory goals. It protects the interests of consumers in diverse programming choices on regulated tiers, of cable program services in open markets, and of cable operators in selecting programming without facing artificial and unnecessary economic concerns. NBC supports adoption of the third option, modified as suggested, or of any superior option that allows operators to recover increases in programming costs and to maintain a reasonable profit margin.

Respectfully submitted,

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